No. 14,374

United States Court of Appeals
For the Ninth Circuit

S. Nicholas Jacobs and Dolores I. Jacobs,
Petitioners,

vs.

Commissioner of Internal Revenue,
Respondent.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

The main questions in this case raised in Respondent's brief turn on whether in light of the facts specially found by the Tax Court and the undisputed evidence before the Tax Court the so-called "ultimate finding of fact" (Tr. p. 95) that "the conveyance of Subdivision No. 3 of Hollywood Subdivision, Inc.; the issuance of the stock of Hollywood Subdivision, Inc., to petitioner; the transfer of such stock by petitioner to Hollywood Terrace, Inc., and the receipt by petitioner of a note in the sum of $175,000 were component parts of a single transaction, by which petitioner effected a sale of land in the ordinary course of business" is a finding of fact or an erroneous conclusion of law from the facts specially found by the Tax Court, or if it be a finding of fact, whether it is supported by the evidence.

If the main questions are decided against petitioners, there is a subsidiary question whether taxpayers are

entitled to report the gain on the installment basis. This reply brief will deal with these questions and certain miscellaneous matters raised by Respondent's Brief.

I. THE SO-CALLED "ULTIMATE FINDING OF FACT" IS EITHER (a) AN ERRONEOUS CONCLUSION OF LAW OR (b) A FINDING OF FACT UNSUPPORTED BY SUBSTANTIAL EVIDENCE.

(a) The so-called "ultimate finding of fact" is an erroneous conclusion of law.

There is a specific finding that Mr. MacBride

> "was told by petitioner's attorney, in the presence of petitioner, that he could not buy the land; that the land was not for sale; and that he would not be permitted to be a real estate broker in the sale thereof. MacBride was informed by petitioner's attorney, in the presence of petitioner, that he might obtain control of the land by purchasing the stock of a corporation owning the land. The attorney further told MacBride that the stock of the corporation was not for sale at that time; that, if, after the stock was issued in exchange for the land he was still interested in purchasing the stock, negotiations to that end could be instituted; but that, in the meantime, petitioner could abandon his plan to transfer the land to the corporation in exchange for the stock, or MacBride could change his plan to submit an offer for the stock;" (Tr. pp. 92-3)

As a legal interpretation of the specific findings, the conclusion of a single transaction (Tr. p. 95) is erroneous and inconsistent with the special findings.

> *Skemp v. Commissioner* (C.A. 7th, 1948) 168 F. (2d) 598, 599.

Moreover it disregards the fact that if the corporation had continued to function it could not have been described as a sale of land in the ordinary course of business. The dissolution took place after the MacBride interests took control.

(b) The so-called "ultimate finding of fact" is unsupported by substantial evidence.

This court in considering the scope of its review of a decision of the Tax Court after the amendment in 1948 of Section 1141(a)[1] which in effect overturned the ruling of the Supreme Court in *Dobson v. Commissioner* (1943) 320 U.S. 489 as to the finality of the determination by that court particularly in respect to facts, said:

> "it is axiomatic that uncontradicted testimony must be followed." (*Grace Bros., Inc. v. Commissioner* (C.A. 9th, 1949) 173 F.(2d) 170 at p. 174.)

In support of this statement this court cites the following cases:

> *Chesapeake and Ohio Ry. v. Martin* (1931) 283 U.S. 209, 216-217;
>
> *San Francisco Association for the Blind v. Industrial Aid* (C.A. 8th, 1946) 152 F.(2d) 532, 536;
>
> *Foran v. Commissioner* (C.A. 5th, 1948) 165 F.(2d) 705.

In *Foran v. Commissioner,* supra, the question involved was whether the gain from the sale of oil producing lands

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[1]Unless otherwise specifically stated, all references to Sections herein refer to the Internal Revenue Code as amended, which said Code is Title 26 of the United States Code (U.S.C.).

was taxable as a capital gain or as ordinary income. The sole witness, who was the taxpayer and who was in the oil royalty brokerage business and had purchased and sold some gas properties in his own name, had testified that when the properties in controversy became proven as producing he decided to hold them as an investment. The Tax Court found against that testimony. The Court of Appeals reversed directing that the taxes be determined in accordance with that opinion and in so doing said:

> "Here there is direct and positive evidence from the witness who best knows, that this property was for eighteen months being held as an investment and not held for sale to customers. His testimony is consistent with every proven fact. He gives a credible reason why it was not for sale and why finally in 1941 he did sell it. We think the court's refusal to follow the sworn testimony is contrary to law, and requires the setting aside of its fact-finding as it would that of a jury. We quote from *Pennsylvania R.R. Co. v. Chamberlain,* 288 U.S. 333, at page 340, 53 S. Ct. 391, 394, 77 L. Ed. 819, 'And the desired inference is precluded for the further reason that respondent's right of recovery depends upon the existence of a particular fact which must be inferred from proven facts, and this is not permissible in the face of the positive and otherwise uncontradicted testimony of unimpeached witnesses consistent with the facts actually proved, from which testimony it affirmatively appears that the fact sought to be inferred did not exist. This conclusion results from a consideration of many decisions, of which the following are examples: (citing cases.) A rebuttable inference of fact * * * "must necessarily yield to credible evidence of the actual occurrence."' We recognize that intent may be

proved by circumstances, and that a party's testimony as to his intent may be rebutted by proof of circumstances which are inconsistent therewith. We hold that no circumstance found by the Tax Court here is inconsistent with the reasonable and uncontradicted testimony of Foran." (p. 707)

The uncontradicted testimony in this case is that

"Mr. MacBride was told, in what I would describe as unmistakable language, by me, that under no circumstances would Dr. Jacobs or Hollywood Subdivision, Inc. sell to Mr. MacBride or anybody else so that he, Mr. MacBride, could act as the agent in the sale to anyone else, any part of the real estate. He was told that there would be no program for a commitment, that we could run out, he could run out of it, and that there was never to be anything binding. . . ." (Tr. pp. 52-3.)

This testimony is not contradicted and is in effect specially found by the Tax Court (Tr. pp. 92-3). Also see Petitioners' Opening Brief pages 5 and 24 and Respondent's Brief page 5.

We concede that where the parties to a transaction formulate a plan which contemplated several steps to accomplish the end result *and bind themselves by contract to carry out the plan,* steps taken pursuant to the contract constitute a single transaction. This is the position taken by this court in the following cases:

Barker v. United States (C.A. 9th, 1952) 200 F. (2d) 223, 231 (cited in Respondent's Brief, p. 10);

Halliburton v. Commissioner (C.A. 9th, 1935), 78 F.(2d) 265, 267 (cited in Respondent's Brief, p. 10);

Von's Inv. Co. v. Commissioner (C.A. 9th, 1937), 92 F.(2d) 861, 864 (cited in Respondent's Brief, p. 11).

In this case the uncontradicted testimony shows that the parties did not bind themselves by contract to carry out any plan. The Tax Court specially found

> ". . . that the stock of the corporation was not for sale at that time; that, if, after the stock was issued in exchange for the land he was still interested in purchasing the stock, negotiations to that end could be instituted; but that, in the meantime, petitioner could abandon his plan to transfer the land to the corporation in exchange for the stock, or MacBride could change his plan to submit an offer for the stock; . . ." (Tr. pp. 92-93.)

The so-called "ultimate finding of fact" that the conveyance in exchange for stock and the sale of the stock were "component parts of a single transaction" (Tr. p. 95) is inconsistent with the special finding and the uncontradicted evidence.

The intent and purpose of the parties was to keep each transaction separate and apart. This is made plain by the special finding that the stock of the corporation was not *then* for sale; that if, *after* the stock was issued in exchange for the land Mr. MacBride "was still interested in purchasing the stock, negotiations to that end could be instituted; but that, in the meantime, petitioner could abandon his plan to transfer the land to the cor-

poration in exchange for the stock, or MacBride could change his plan to submit an offer for the stock; . . ." (Tr. pp. 92-93.) If the intent and purpose of the parties is to control, as this court held in *Von's Inv. Co. v. Commissioner, supra,* then there was not a single transaction.

We concede that *Houck Jr. v. Hinds* (C.A. 10th, Aug. 20, 1954) 545 CCH Par. 9567 1954 P-H Par. 72,742 (Respondents' Brief p. 11) does say and hold that

> "Whether for tax purposes several acts constitute separate and distinct transactions or are integrated steps in a single transaction is a question of fact."

We do question its soundness as applied to the facts of this case. The evidence before the trial court in the *Houck* case was not before the appellate court. It was rightly assumed the finding was supported by the evidence. That is not this case. If the question is one of fact it must be found in accordance with the testimony.

The other cases cited by respondent (his brief p. 11)[2] neither say nor hold "that whether there is a single transaction or several is a question of fact;" at least we cannot find the words that say or resemble the last quoted statement made by respondent concerning them.

So much for the main questions. We now turn to the subsidiary question.

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[2] *Von's Inv. Co. v. Commissioner* (C.A. 9th, 1937) 92 F.(2d) 861, 864;
Commissioner v. Laughton (C.A. 9th, 1940) 113 F.(2d) 103, 104;
Heller v. Commissioner (C.A. 9th, 1945) 147 F.(2d) 376, 378.

II. IF THE TRANSACTION IS IN SUBSTANCE A SALE OF LAND, TAXPAYERS ARE ENTITLED TO REPORT THE GAIN ON THE INSTALLMENT BASIS.

We do not now assert, and never have asserted, that the gain on the sale of a capital asset cannot be reported on the installment basis. (Resp. Br. pp. 20-21.) Taxpayers treated the transaction in their return as a sale of capital stock for a note with a fair market value of $125,000 (Tr. p. 74), which note was due December 1, 1948.[3] That we still believe to be the true facts and are so contending before this court. On such a sale there could be no return on an installment basis because no portion of the note was payable in a later year. If, however, this court should determine in substance there was a sale of land, thereby disregarding the form, it seems to us inevitable that this court will have to disregard all form and determine that there was the sale of land paid for in the years 1948 through 1951 as follows:

Year	Payment
1948	$28,364.57
1949	74,762.98
1950	12,225.77
1951	7,201.41

If this be the substance of the transaction for the first time we have installments payable in later years; for the first time taxpayers have an election. We believe that in fairness they should be permitted to exercise it. If Respondent can disregard facts, he should not be per-

[3]The due date does not appear in the record and if material perhaps will have to be disregarded as not in the record.

mitted to disregard only the facts which increase taxpayer's income taxes.

If *Scales v. Commissioner* (C.A. 6th, 1954) 211 F.(2d) 133, is sound, and we believe it is, it should be applied here. In addition to what we said concerning that case in petitioners' opening brief, we direct this court's attention to the following language of the *Scales* case (18 TC 1262):

> "Judicial decisions have generally required taxpayers to make an affirmative election in a timely filed income tax return in order to elect to report a sale of property on the installment method under section 44(b), I.R.C. Once an election has been made to report a sale as a completed transaction, in a subsequent year the taxpayer could not recompute his tax liability by changing to the installment method. Pacific Nat'l Co. v. Welch, 304 U.S. 191 [38-1 USTC Par. 9286].[4] Where a taxpayer fails to file timely tax returns, he cannot use the installment method, Cedar Valley Distillery, Inc. 16 T.C. 870, 882 [Dec.

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[4]Into this same category fall the following cases cited by respondent in his brief (pp. 21-23): *United States v. Kaplan,* 304 U.S. 195; *Pacific National Co. v. Welch,* 91 F.(2d) 590; *Riley Co. v. Commissioner,* 311 U.S. 55; *Helvering v. Wilshire Oil Co.,* 308 U.S. 90; *Alameda Inv. Co. v. McLaughlin,* 33 F.2d 120 (C.A. 9th); *Commissioner v. Saunders,* 131 F.2d 571 (C.A. 5th); *Moran v. Commissioner,* 67 F.2d 601 (C.A. 1st); *Strauss v. Commissioner,* 87 F.2d 1018 (C.A. 2d); *Marks v. United States,* 98 F.2d 564 (C.A. 2d), certiorari denied, 305 U.S. 652; *Thrift v. Commissioner,* 15 T.C. 366. None of these cases involved facts like the case at bar. None involved a similar type of change as is here asserted by respondent in this case. From the opinion of the Tax Court we believe that these same cases were presented to the Court of Appeals in the *Scales* case.

18,245]; Sarah Briarly, 29 B.T.A. 256, 258-259 [Dec. 8273]. (p. 1274.)

* * *

"Petitioner relies principally on United States v. Eversman, 133 Fed. (2d) 261 [43-1 USTC Par. 9284]. The Court there held that though no special ritual had to be followed to report on the installment basis, the circuit court emphasized the fact that a complete disclosure of all relevant facts was made on that return. In the instant case we have no such complete disclosure. We hold that the petitioner cannot now claim the right to report the capital gain from the sale of the dairy farm and cattle on the installment basis." (p. 1275.)

The Court of Appeals reversed the Tax Court. We respectfully request this court to read the opinion of the Tax Court on issue 1 (18 T.C. p. 1273) and the entire one page opinion of the Court of Appeals (C.A. 6th, 1954), 211 F.(2d) 133.

While at page 11 of respondent's brief he asserts that whether there is a single transaction or several is a question of fact, at page 24 he asserts there was no mistake as to the facts. Taxpayer was no more informed as to the facts or the law than were taxpayers in *Scales v. Commissioner,* supra.

So much as to taxpayers' right to elect; now for a brief reply to miscellaneous matters.

III. A BRIEF REPLY TO CERTAIN MISCELLANEOUS MATTERS RAISED BY RESPONDENT'S BRIEF.

(a) The record is clear the taxpayer reported and paid large taxes on the sale of the capital stock,[5] hence it was not the purpose of taxpayer to avoid taxes. We concede that it was planned to reduce or minimize taxes.[6] If respondent uses the word "avowed" (Respondent's Brief p. 13) in the sense of declaring openly, as something one is not ashamed of (Webster's New International Dictionary, Second Edition), then counsel for petitioners now openly avows that he always advises every client, and always intends, to minimize the amount of income taxes by means which the law permits. A motive to reduce the amount of taxes "will not establish liability if the transaction does not do so without it." (*Chamberlin v. Commissioner* (C.A. 6th, 1953) 207 F.(2d) 462 at p. 468, certiorari denied 347 U.S. 918.)

(b) There was no implied understanding (Respondent's Brief pp. 17-19). Respondent's counsel might as well have suggested that the testimony was perjured. The suggestion is contrary to the Tax Court's finding that "the attorney further told MacBride that the stock of the corporation was not for sale at that time; that, if, after the stock was issued in exchange for the land he was still interested in purchasing the stock, negotiations to that end could be instituted; but that, in the meantime,

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[5]The tax on the capital gain is $22,714.62 (25% of the profit of $90,858.47).

[6]On ordinary income the tax as determined by the Tax Court is $61,702.12 (67.91% of the profit of $90,858.47). If the corporation, still owned by the taxpayer, had sold the land, the taxes would have been $34,526.22 (38% of the profit of $90,858.47).

petitioner could abandon his plan to transfer the land to the corporation in exchange for the stock, or MacBride could change his plan to submit an offer for the stock;'' (Tr. pp. 92-93.)

(c) Respondent twice asserts that MacBride had been advised by taxpayer's counsel that MacBride form a corporation (Respondent's Brief pp. 18 and 20, referring on p. 18 to Tr. 35). The record does not support this charge. Mr. MacBride had his own brother as his attorney (Tr. p. 53). There is nothing in the record (Tr. p. 35) that states that Mr. MacBride was advised by taxpayer's counsel to form a corporation. If statement of taxpayer's counsel is evidence or part of the record, the record shows that Mr. MacBride ''had been told if that were so he had better form a corporation and have that so that if that step ever arrived, he could do that.'' (Tr. p. 35.) That is no statement that he had been so advised by taxpayer's counsel. Mr. MacBride was present in the courtroom. (Tr. p. 56.) The respondent did not choose to call him as a witness.

(d) We made no suggestion that a business purpose for Hollywood Subdivision, Inc. could be found in the fact that a deficiency judgment could be obtained on a stock sale but not on a real estate sale. (Resp. Brief, p. 20.) Business purposes are discussed in petitioner's opening brief at pages 21 to 23. Deficiency judgments are not mentioned there. Under the heading ''SUBSTANCE OR FORM'' we did assert that whether a deficiency judgment is obtainable is a matter of substance and not of form (Pet. Brief p. 37). We repeated that assertion in the conclusion (Pet. Brief, pp. 40-41).

It is consistent with Mr. MacBride's creation of Hollywood Terrace, Inc. that Mr. MacBride knew when he was buying land he could buy it himself without liability for a deficiency but when he bought stock that was not so. Hence the creation of Hollywood Terrace, Inc.[7]

(e) Respondent asserts (his brief p. 9) that "taxpayer was willing to dispose of his land." This is in flat contradiction of the finding of the Tax Court that Mr. MacBride was told by petitioners' attorney "that the land was not for sale." (Tr. p. 92.)

(f) Respondent by footnote (his brief p. 17, footnote 2) casually dismisses our argument that the exchange of the land for the stock was a separate transaction saying "its relevance is remote." On the other hand, we think it essential because if at the time of the exchange there was a commitment to put control in Mr. MacBride, the exchange was not tax free. Thus at the threshold any tax saving had been knowingly and deliberately destroyed. Thus it is made plain that it was the intent to have separate transactions.

(g) If the several transactions as "a single transaction" are in violation of the Corporate Securities Act, it is evidence of intent, motive and purpose to have several separate transactions and not one single transaction.

(h) When respondent admits that there was no "enforceable agreement" or "binding commitment", he in effect admits there were separate transactions.

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[7]We do not claim this was of financial benefit to taxpayer, as the buying corporation had little or no assets other than that of the stock it purchased.

> ". . . there was no written contract prior to the exchange binding the associates to transfer stock to the underwriters. At the most there was an informal oral understanding of a general plan contemplating the organization of a new corporation, the exchange of assets for stock, and marketing of preferred stock of the new corporation to the public. A written contract providing for the transfer of shares from the associates to the underwriters did not come until five days after the exchange."

American Bantam Car Co. v. Commissioner (1948) 11 T.C. 397 at p. 406; affirmed (1949) 177 F.(2d) 513; cert. denied (1949) 399 U.S. 420, and see cases cited petitioners' opening brief p. 14. Upon the completion of the exchange of land for stock, the corporation could have sold the land, as it could after the sale of the stock to Mr. MacBride. The ownership or control requirement of Section 112(b)5 is nonetheless complied with if the sale to MacBride was not required as part of the exchange.

CONCLUSION.

As we read *Chamberlin v. Commissioner, supra, American Bantam Car Co. v. Commissioner, supra,* and *United States v. Cumberland Public Service Co.* (1950) 338 U.S. 451, 70 S.Ct. 280, in contrast with *Commissioner v. Court Holding Company* (1945), 324 U.S. 331, 65 S.Ct. 707, if a taxpayer refuses to sell land, but counters with the suggestion that if, after the land was transferred to a corporation in exchange for stock, the proposed buyer was interested in buying the stock, negotiations to that

end could then be instituted, and if when the land was exchanged for the stock, there was no binding agreement for the sale of the stock, and shortly thereafter negotiations result in the sale of the stock, the tax consequences are a sale of stock and not a sale of land. While the distinction between sales of land by its owner and sales of the stock of a corporation exchanged for the land may be shadowy and artificial, Congress has chosen to recognize such a distinction for tax purposes. That Congressional mandate controls petitioners, respondent and this court. We have a government of laws, not of men. We respectfully request this court to reverse the Tax Court and direct that it enter its order determining petitioners' income taxes for 1948 on the basis that the sale of the stock of Hollywood Subdivision, Inc., resulted in a long term capital gain and not in ordinary income.

Dated, San Francisco, California,
October 11, 1954.

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